

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AGRE-00 DOE-15 SOE-02 SP-02 ICA-20
AID-05 EB-08 NSC-05 TRSE-00 SS-15 STR-07 OMB-01
CEA-01 CIAE-00 COME-00 FRB-01 INR-10 NSAE-00
XMB-04 OPIC-06 LAB-04 SIL-01 H-02 L-03 PA-02
HA-05 /132 W

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R 152029Z MAY 78
FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC 7408
INFO AMCONSUL CALGARY
AMCONSUL HALIFAX
AMCONSUL MONTREAL
AMCONSUL QUEBEC
AMCONSUL TORONTO
AMCONSUL VANCOUVER
AMCONSUL WINNIPEG

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DEPT. PASS CEA, TREAS, FRB

E.O. 11652:N/A
TAGS: ECON, EFIN, CA
SUBJECT: ECONOMIC DEVELOPMENTS: WEEK ENDING MAY 5.

1. SUMMARY. PRIVATE FORECASTERS SOMEWHAT MORE PESSIMISTIC ON SHORT RUN GROWTH AND INFLATION PROSPECTS. NEW DEMOCRATIC PARTY (NDP) HAS PROPOSED MORE GROWTH STIMULUS AND DIRIGISTE SOLUTION TO STRUCTURAL PROBLEMS. CANADIAN DOLLAR EXCHANGE RATE FIRM IN QUIET MARKET. FEDERAL BUDGET DEFICIT TOTALLED CDOLS 8.5 BILLION IN FY 1977/78. BANK ACT MAY SOON BE TABLED IN PARLIAMENT. UNEMPLOYMENT RATE UNCHANGED IN APRIL. WHOLESALE PRICES AND INDUSTRIAL SELLING PRICES DECELERATED IN MARCH. SURVEYS SHOW IMPROVEMENT IN BUSINESS EXPECTATIONS, BUT GROWTH OF PROFITS AND CONSUMER UNCLASSIFIED

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CONFIDENCE SAGGED IN FIRST QUARTER. SHORT TERM INTEREST RATES DECLINED IN WEEK AND BOND PRICES WERE UP. SLOW M1 GROWTH REFLECTS RECENT INCREASES IN BANK RATE. PACE OF FOREIGN BORROWING QUICKENING. END SUMMARY.

2. SHORT TERM OUTLOOK. PRIVATE FORECASTERS HAVE BECOME MORE PESSIMISTIC CONCERNING SHORT TERM OUTLOOK FOR GROWTH

AND INFLATION. WOOD GUNDY NOW FORECASTS REAL GNP GROWTH OF 3.8 PERCENT IN 1978 AND 3.2 PERCENT IN 1979, COMPARED WITH PREVIOUS FORECASTS OF 4 PERCENT IN EACH YEAR. ROYAL BANK HAS REVISED 1978 GROWTH FORECAST DOWN FROM 3.3 PERCENT TO 3.0 PERCENT BUT HAS NOT CHANGED ITS 1978 FORECAST OF 4 PERCENT. SLOWER THAN EXPECTED GROWTH OF PRIVATE INVESTMENT AND OF GOVERNMENT SPENDING ARE MAIN REASONS FOR LOWER GROWTH PROJECTIONS. IN ADDITION, GOC AND PRIVATE ECONOMISTS ARE INCREASINGLY CONCERNED THAT CONTINUING HIGH RATES OF INFLATION COULD LEAD TO ACCELERATION OF WAGE INCREASES AND OF UNIT LABOR COSTS, PARTICULARLY IN 1979.

3. EXCHANGE RATE. CANADIAN DOLLAR EXCHANGE RATE SHOWED IRREGULAR UPWARD MOVEMENT DURING WEEK IN GENERALLY QUIET MARKET. DOLLAR APPROACHED 89 U.S. CENTS EARLY IN WEEK FOLLOWING ANNOUNCEMENT OF LARGE (CDOLS 840 MILLION) MARCH TRADE SURPLUS, BUT SUBSEQUENTLY WEAKENED WITH NEWS THAT OFFICIAL RESERVES WOULD HAVE DECLINED BY U.S.DOLS 737 MILLION IN APRIL WITHOUT ADDITION TO RESERVES OF U.S.DOLS 1.35 BILLION IN FEDERAL FOREIGN BORROWINGS. ANNOUNCEMENT OF STANDBY CREDIT OF U.S.DOLS 3 BILLION WITH U.S. BANKS AND INCREASED COMMERCIAL DEMAND TOGETHER WITH OFFICIAL INTERVENTION ACTED TO STRENGTHEN DOLLAR LATE IN WEEK. DOLLAR CLOSED AT 88.68 U.S. CENTS AT THE END OF THE WEEK AND HAS SINCE TRADED WELL ABOVE 89 U.S. CENTS.

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4. ECONOMIC POLICY. NEW DEMOCRATIC PARTY (NDP) HAS ANNOUNCED PACKAGE DESIGNED TO REDUCE UNEMPLOYMENT RATE TO 6 PERCENT IN 18 MONTHS. PROGRAM FEATURES CDOLS 1.5 IN TAX CUTS AND INCREASED SPENDING ON JOB CREATION TO BE FINANCED LARGELY BY HIGHER TAXES IN BUSINESS. NDP ALSO CALLED ESTABLISHMENT OF PRODUCTION AND INVESTMENT TARGETS FOR LARGE FIRMS AND FOR CONTROLS ON LARGE TRANSFERS OF FUNDS ABROAD BY COMPANIES.

5. BANK ACT. DURING QUESTION PERIOD IN HOUSE OF COMMONS, POLITICAL OPPOSITION PRESSED GOC TO TABLE PROPOSED REVISIONS TO BANK ACT. FINANCE MINISTER CHRETIEN INDICATED THAT LEGISLATION COULD BE TABLED WITHIN NEXT FEW WEEKS. NOW THAT ELECTIONS HAVE BEEN PUT BACK UNTIL FALL OR NEXT SPRING, GOC IS LIKELY TO PROCEED WITH THIS INTENTION.

6. ECONOMIC INDICATORS:

-- UNEMPLOYMENT RATE WAS CONSTANT IN APRIL AT MARCH LEVEL OF 8.6 PERCENT. EMPLOYMENT EXPANDED AND UNEMPLOYMENT AND PARTICIPATION RATE DECLINED SLIGHTLY. (OTTAWA 2422)

-- WHOLESALE PRICE INDEX ADVANCED 0.2 PERCENT TO 587.7
(1935-39 EQUALS 100) IN MARCH AND STOOD 5.9 PERCENT ABOVE LEVEL
OF MARCH, 1977, COMPARED WITH 12 MONTH RISE OF 8.4 PERCENT
REGISTERED IN FEBRUARY. PRICES OF WOOD, IRON AND TEXTILES
ROSE SHARPLY.

-- INDEX OF INDUSTRIAL SELLING PRICES WAS 182.6 (1971 EQUALS
100) IN MARCH, UP 0.5 PERCENT FROM FEBRUARY AND 6.8 PERCENT
FROM MARCH, 1977. SECTORS CONTRIBUTING MOST TO RISE WERE
FOOD/BEVERAGE AND WOOD INDUSTRIES. INDEX ROSE 8.7 PERCENT
IN TWELVE MONTHS TO FEBRUARY.

-- STATCAN MARCH SURVEY OF PRODUCTION INTENTIONS INDICATES
THAT 39 PERCENT OF FIRMS SAMPLED EXPECTED OUTPUT TO INCREASE
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IN SECOND QUARTER OVER FIRST QUARTER, WHILE 14 PERCENT

EXPECTED DECLINES. JANUARY SURVEY SHOWED 28 PERCENT EXPECTING HIGHER PRODUCTION IN FIRST QUARTER OF 1978 COMPARED WITH PREVIOUS QUARTER AND 22 PERCENT ANTICIPATING A DECLINE. RESPONDENTS IN MARCH SURVEY WERE ALSO MORE OPTIMISTIC CONCERNING LEVELS OF NEW ORDERS AND UNFILLED ORDERS AND 80 PERCENT DESCRIBED THEIR LEVEL OF INVENTORIES AS "ABOUT RIGHT".

-- PRIVATE SURVEY OF 141 COMPANIES SHOWS THAT AFTER TAX PROFITS OF THESE FIRMS AVERAGED CDOLS 1 BILLION IN FIRST QUARTER, UP 11.7 PERCENT FROM FIRST QUARTER, 1977 AVERAGE. FIRST QUARTER INCREASE REPRESENTS DECLARATION FROM 16.9 RISE IN FOURTH QUARTER, 1977. MINING, OIL REFINING AND REAL ESTATE SECTORS HAD LARGEST DECLINES. SECTORS REGISTERING HEALTHY INCREASES WERE BANKS, CHEMICALS, FOREST UNCLASSIFIED

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PRODUCTS AND UTILITIES.

-- CONFERENCE BOARD'S INDEX OF CONSUMER CONFIDENCE SLUMPED TO 83.8 IN FIRST QUARTER OF 1978 FROM FOURTH QUARTER 1977 LEVEL OF 91.9. REASONS CITED FOR DECLINE WERE UNCERTAIN OUTLOOK FOR CONSUMERS' FINANCIAL POSITION, AS WELL AS FOR INFLATION AND UNEMPLOYMENT. HOWEVER, PROPORTION OF RESPONDENTS EXPECTING TO PURCHASE CONSUMER DURABLES (ESPECIALLY AUTOS) ROSE FROM 27.2 PERCENT TO 29.3 PERCENT IN FIRST QUARTER.

-- FEDERAL GOVERNMENT DEFICIT WAS CDOLS 1.45 BILLION IN MARCH, BRINGING TOTAL DEFICIT FOR FY 1977/78 TO CDOLS 9.3 BILLION. OVER FISCAL YEAR, TAX REVENUES ROSE ONLY 0.7 PERCENT TO CDOLS 32.1 BILLION, WHILE EXPENDITURES WERE UP 10.6 PERCENT TO CDOLS 41.4 BILLION. INCLUDING NON-BUDGETARY TRANSACTIONS, DEFICIT WAS CDOLS 8.5 BILLION. TOTAL FINANCING REQUIREMENT WAS CDOLS 7.3 BILLION, REFLECTING BUILD-UP OF GOC CASH POSITION DUE IN PART TO OFFICIAL PURCHASES OF CANADIAN DOLLARS TO SUPPORT EXCHANGE RATE.

7. CAPITAL MARKETS. RELATIVE CALM IN EXCHANGE MARKET HAS CONTRIBUTED TO DECLINE IN INTEREST RATES. INTEREST RATE ON THREE MONTH TREASURY BILLS WAS 8.13 PERCENT IN WEEK, COMPARED WITH 8.19 PERCENT AND 8.24 PERCENT RESPECTIVELY IN TWO PREVIOUS WEEKS. BOND PRICES ROSE 3/8 POINT. GOC CDOLS 700 MILLION BOND ISSUE SOLD AT PAR AND ROSE TO PREMIUM IN SECONDARY MARKET.

8. INCREASES IN BANK OF CANADA (BOC) DISCOUNT RATE (100 BASIS POINTS IN TWO MONTHS) AND WEAK PRIVATE SECTOR LOAN DEMAND HAVE CAUSED SLOWDOWN IN GROWTH OF M1. SEASONALLY ADJUSTED M1 STOOD AT CDOLS 21.3 BILLION IN APRIL, JUST

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BELOW LOWER LIMIT OF BOC'S 7-11 PERCENT TARGET RANGE. WITH LATEST INCREASE IN U.S. DISCOUNT RATE, GOC MAY AGAIN HAVE TO FACE DIFFICULT CHOICE BETWEEN DEFENDING EXCHANGE RATE WITH HIGHER INTEREST RATES (OR RUNDOWN IN RESERVES) AND ACCEPTING FURTHER EXCHANGE RATE DEPRECIATION AND THE MORE RAPID INFLATION WHICH WOULD RESULT.

9. WOOD GUNDY ESTIMATES TOTAL GROSS PRIVATE AND PUBLIC BORROWING (OVER 3 YEARS IN MATURITY) OF NEARLY CDOLS 5.0 BILLION IN FIRST QUARTER OF 1977. FEDERAL BORROWING OVER THIS PERIOD TOTALLED CDOLS 2.2 BILLION; PROVINCIAL BORROWING, CDOLS 1.5 BILLION AND PRIVATE BORROWING CDOLS 304 MILLION. TOTAL BORROWING IN FIRST QUARTER OF 1977 WAS CDOLS 4.8 BILLION. PORTION OF FUNDS RAISED IN FOREIGN MARKETS WAS 48.6 PERCENT IN FIRST QUARTER OF 1978 AND 39.7 PERCENT IN FIRST QUARTER OF LAST YEAR.

10. FOREIGN BORROWING. PACE OF FOREIGN BORROWING BY PROVINCES HAS ACCELERATED. PROVINCE OF NEWFOUNDLAND EXPECTED TO FLOAT U.S.DOLS 50 MILLION ISSUE IN EUROMARKET SOON. ONTARIO HYDRO PLANS U.S.DOLS 150 MILLION ISSUE IN EUROMARKET. PROVINCE OF MANITOBA HAS RECENTLY COMPLETED A SWISS FRANC 100 MILLION ISSUE. PROVINCE OF QUEBEC IS IN FINAL STAGES OF NEGOTIATING 30 BILLION YEN (CDOLS 150 MILLION) ISSUE IN JAPANESE MARKET. ENDERS

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